

[Senate Bill 591](#) (Pan)

Date: Introduced

Program: Cigarette and Tobacco Products Tax

Sponsor: Author

RTC Sections 30104, 30108, 30181, and Article 2.5 (commencing with Section 30130.50)

Effective immediately but tax operative 1<sup>st</sup> day of 1<sup>st</sup> calendar quarter 90 days later.

Michele Pielsticker (Chief) 916.322.2376

Cindy Wilson (Analyst) 916.445.6036

Joe Fitz (Revenue) 916.445.0840

***This analysis only addresses the provisions that impact the Board of Equalization (BOE).***

**Summary:** Among other things, imposes a new \$2 per pack cigarette tax, an equivalent floor stock tax,<sup>1</sup> and indirectly increases the tobacco products tax.

**Purpose:** To decrease smoking rates, improve access to health care, and advance California's tobacco prevention and control programs.

**Fiscal Impact Summary:** \$1.178 billion for the California Tobacco Tax Act of 2014 Fund, after existing fund backfill.

**Existing Law: Cigarette and Tobacco Products Tax Law.** Existing law imposes an \$0.87 per package of 20 (43 ½ mills per cigarette) cigarette tax. The cigarette tax components and the revenue disposition are as follows:

- \$0.10 per pack (5 mills per cigarette) is allocated to the General Fund (Sections 30101 and 30462 of the Revenue and Taxation Code (RTC));
- \$0.02 per pack (1 mil per cigarette) is allocated to the Breast Cancer Fund (RTC Sections 30101 and 30461.6);
- \$0.25 per pack (12 ½ mills per cigarette) is allocated to the Cigarette and Tobacco Products Surtax Fund (RTC Sections 30122 and 30123); and
- \$0.50 per pack (25 mills per cigarette) is allocated to the California Children and Families (CCF) Trust Fund (RTC Sections 30131.2 and 30131.3).

RTC Section 30123 imposes a tax upon the distribution of tobacco products, based on the wholesale cost of these products at a tax rate that is equivalent to the combined rate of tax imposed on cigarettes. In addition, Section 30131.2 imposes an additional tobacco products tax at a rate equivalent to the \$0.50 per pack cigarette tax. The BOE determines the tobacco products tax rate annually based on the March 1 wholesale cost of cigarettes. The 2014-15 tobacco products rate is 28.95%.

The Board of Equalization (BOE) deposits the tobacco products surtax imposed under Section 30123 into the Cigarette and Tobacco Products Surtax Fund (including any revenues that result from an indirect increase in the tobacco products tax triggered by a cigarette tax increase). The BOE deposits the tobacco products surtax imposed under Section 30131.2 into the CCF Trust Fund.

**Proposition 10 Backfill.** Health and Safety Code (HSC) Section 130105<sup>2</sup> requires the BOE annually to determine the revenue reductions to any Proposition 99 state health-related education and research programs and the Breast Cancer Fund that result directly from Proposition 10's additional taxes. These reductions may result from reduced consumption or increased black market activity due to the

---

<sup>1</sup> A floor stock tax is a one-time tax on all tax-paid (stamped) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette and tobacco products tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate.

<sup>2</sup> Added by Proposition 10.

increased tax. HSC Section 130105 also requires funds to be transferred from the CCF Trust Fund to affected programs to offset these revenue reductions.

**Cigarette and Tobacco Products Licensing Act<sup>3</sup> (Licensing Act).** The Licensing Act requires the BOE to administer a statewide program to license cigarette and tobacco products manufacturers, importers, distributors, wholesalers, and retailers. Business and Professions Code (BPC) Section 22970.1 includes legislative findings and declarations that state “tax revenues have declined by hundreds of millions of dollars per year due, in part, to unlawful distributions and untaxed sales of cigarettes and tobacco products conducted by organized crime syndicates, street gangs, and international terrorist groups.” Section 22970.1 further provides that “the licensing of manufacturers, importers, wholesalers, distributors, and retailers will help stem the tide of untaxed distributions and illegal sales of cigarette and tobacco products.”

**Proposed Law: Cigarette Tax Increase.** This measure enacts **The California Tobacco Act of 2015<sup>4</sup>** (Tobacco Act) to impose an additional cigarette tax at a rate of \$2 per package of 20. The Tobacco Act imposes the additional cigarette tax “on or after the first day of the first calendar quarter commencing more than 90 days after the effective date” of the bill.

**Floor Stock Tax.** This measure also imposes a compensating floor stock tax on every dealer (retailer) and wholesaler for each cigarette in his or her possession or control at 12:01 a.m. on the operative date of the additional tax. In addition, this measure imposes upon every licensed distributor a cigarette indicia adjustment tax on affixed and unaffixed cigarette tax stamp inventory at 12:01 a.m. on the operative date of the additional tax. The floor stock tax return and tax would be due to the BOE “on or before the first day of the first calendar quarter commencing more than 180 days after the effective date” of the bill.

**Backfill Provisions.** The BOE would determine, within one year of passage and annually thereafter, the effect that the additional cigarette tax and the resulting indirect tobacco products tax increase on cigarette and tobacco products consumption in this state. If the BOE determines the additional cigarette and indirect tobacco products tax directly caused a consumption decrease, the bill requires the BOE to determine the fiscal effect of the consumption decrease on the CFF Trust Fund (Proposition 10), the Cigarette and Tobacco Products Surtax Fund (Proposition 99), the Breast Cancer Fund, and the General Fund, as described.

The bill requires the BOE to transfer funds from the California Tobacco Tax Act of 2014 Fund (Tobacco Tax Fund) to the CCF Trust Fund, the Hospital Services Account, the Physician Services Account, the Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, and the General Fund, to offset the revenue decrease that directly results from the additional cigarette tax and indirect tobacco products tax.

**Fiscal Provisions.** Except for payments of refunds, the BOE would deposit all revenues in the newly created Tobacco Tax Fund, which this measure creates in the State Treasury. The Tobacco Tax Fund is established as a trust fund, with amounts transferred in unspecified percentages to the:

- **Tobacco Prevention and Education Account** for transfer to the State Department of Public Health (DPH), State Department of Education, and the University of California.
- **Tobacco Disease Related Health Care Account** for transfer to the State Department of Health Care Services to improve quality and access to specified health care programs.
- **Tobacco Law Enforcement Account** for transfer to the BOE, Department of Justice, and the DPH for the purpose of “supplementing funding for the enforcement of laws that regulate the distribution and sale of cigarettes and other tobacco products, including, but not limited to, laws

---

<sup>3</sup> Division 8.6 (commencing with Section 22970) of the Business and Professions Code (BPC).

<sup>4</sup> Article 2.5 (commencing with Section 30130.50) of Chapter 2 of Part 13 of Division 2 of the RTC.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.

that prohibit cigarette smuggling, counterfeiting, selling untaxed tobacco, selling tobacco without a proper license and selling tobacco to minors, and enforcing tobacco-related laws, court judgments, and settlements.”

The bill also states that no more than 2% of the proposed tax may be used to fund any department’s administrative costs.

**Cigarette and Tobacco Products Tax.** This bill amends several sections within the Cigarette and Tobacco Products Tax Law to add conforming and necessary code section references that allow the BOE to properly administer the surtax in a manner consistent with the existing cigarette and tobacco products tax.

**Operative Date.** The bill becomes effective immediately, but the additional excise tax becomes operative on or after the first day of the first calendar quarter commencing more than 90 days on and after the effective date of the bill.

**Background:** Proposition 99, approved by voters in November 1988 and effective January 1, 1989, imposed a surtax of \$0.25 per package of cigarettes, and also created an equivalent tax on other tobacco products. Tax proceeds provide funding for health education, disease research, hospital care, fire prevention, and environmental conservation.

Assembly Bill 478 (Ch. 660, 1993) and Assembly Bill 2055 (Ch. 661, 1993), effective January 1, 1994, added an excise tax of \$0.02 per package of cigarettes for breast cancer research and early detection services.

Proposition 10, approved by voters in November 1998 and effective January 1, 1999, imposed an additional surtax of \$0.50 per package of cigarettes. Additionally, the measure imposed an additional excise tax on the distribution of tobacco products equivalent to the additional cigarette tax and imposed an equivalent compensating floor stock tax. The additional tax revenues are deposited into the CCF Trust Fund and used to fund early childhood development programs, and to offset any revenue losses to certain Proposition 99 programs resulting from the Proposition 10 tax increase.

## Commentary:

1. **Indirect tobacco products rate increase.** This measure does not directly increase the tobacco products tax; however, existing law triggers an automatic tobacco products tax increase whenever the cigarette tax is increased.<sup>5</sup> Specifically, Section 30123(b), as added by Proposition 99, generally requires the BOE to annually determine the tobacco products tax rate at a rate *equivalent to the combined rate of all taxes imposed on cigarettes*.

Additionally, existing law directs the BOE to deposit these indirect tobacco products tax proceeds into the Cigarette and Tobacco Products Surtax Fund (Proposition 99) to fund health education, disease research, hospital care, fire prevention, and environmental conservation.

2. **Indirect tobacco products increase effective date.** Existing law requires the BOE to annually determine the tobacco products tax rate. As discussed in Comment 1, the \$2.00 per pack cigarette tax increase indirectly increases the tobacco products tax rate as a result of Proposition 99.

With respect to the tobacco products rate determination, existing law requires:

- The BOE to annually determine the tobacco products rate;
- The BOE to base the rate on the wholesale cost of tobacco products as of March 1; and
- The determined tobacco products rate to be effective during the state’s next fiscal year.

---

<sup>5</sup> Imposed under the Cigarette and Tobacco Products Tax Law.

Consequently, the BOE's rate determination must occur no earlier than March 1, but no later than June 30, each year to be effective for the next fiscal year.

Since the last day for the Governor to sign bills is October 11, 2015, latest possible operative date for the proposed additional cigarette tax is April 1, 2016. Accordingly, the 2016-17 tobacco products rate determination would include the proposed tax, effective July 1, 2016.

3. **Administrative start-up cost funding is essential.** The additional cigarette tax would likely be imposed either January 1, 2016, or April 1, 2016, based on the bill's delayed operative date. As a result, the BOE must begin to implement the bill in fiscal year 2015-16. However, the BOE's 2015-16 budget does not include funding to implement the bill. Consequently, the BOE requires an adequate appropriation to cover administrative implementation costs.

Typically, the BOE seeks administrative cost reimbursement from the account or fund into which tax proceeds are deposited. However, this bill creates the Tobacco Tax Fund, which lacks funding to reimburse the BOE prior to collection of the tax. Upfront BOE implementation cost reimbursement is essential. Thus, BOE staff suggests the bill authorize a loan from the General Fund or other eligible fund to the Fund. The loan would be repaid from taxes collected.

Constitutional and statutory provisions prohibit the BOE from using special fund appropriations to support the administration of the proposed cigarette tax increase. Without an appropriation, it may be necessary for the BOE to divert General Fund (GF) dollars to implement the proposed tax program. A GF diversion typically results in a negative impact on GF-supported programs and related State and local government revenues.

4. **Floor stock tax provisions.** The bill contains language to impose a floor stock tax on the cigarette inventory of every dealer (retailer) and wholesaler, and affixed and unaffixed cigarette tax stamp inventory of a distributor. A floor stock tax imposes a one-time tax on all tax-paid (fixed stamp) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate. Generally, a measure imposes a floor stock tax to equalize the excise tax paid by cigarette retailers, wholesalers, or distributors on their inventory and those cigarettes purchased after the effective date of a tax increase.

Without a floor stock tax, a cigarette seller could purchase a large amount of cigarettes before the tax rate increase takes effect. That seller could then sell those cigarettes at a higher price and attributable the higher selling price to the tax increase. The higher selling price in this case represents a windfall profit to the seller rather than excise taxes paid to the state since the cigarettes were purchased at the prior (and lower) tax rate. A floor stock tax mitigates this windfall profit. This measure contains a floor stock tax on cigarettes only, and not tobacco products.

While the BOE incurs additional costs to administer the floor stock tax, these costs would be offset by the tax proceeds.

5. **Tax evasion.** Tax evasion reduces state revenues that cigarettes and other tobacco products taxes generate. BOE staff estimates that cigarette tax evasion in California runs at a rate of approximately \$126 million, along with \$88 million in tax on other tobacco products.<sup>6</sup>

During the mid-1990's, the BOE's cigarette tax evasion estimates remained stable since cigarette prices and excise taxes were fairly constant during that time. However, since November 1998, two major events dramatically increased California excise taxes as well as cigarette prices (excluding taxes): Proposition 10 and the Tobacco Master Settlement Agreement between states and tobacco manufacturers (tobacco settlement). These two developments, coupled with typical wholesaler and

---

<sup>6</sup> <http://www.boe.ca.gov/legdiv/pdf/CigaretteEvasion.pdf>.

retailer distribution margins, coincided with approximately a 50% increase in the average prices of cigarettes to California consumers compared to early November 1998 prices. According to BOE estimates, the impacts of Proposition 10 and the tobacco settlement more than doubled the dollar amount of cigarette tax evasion in California.

Since 1998, many new measures have reduced cigarette and other tobacco products tax evasion. These include the Licensing Act, an encrypted cigarette tax stamp, and the Prevent All Cigarette Trafficking Act (PACT Act).

The substantial cigarette tax imposed by this bill will result in an increase in the retail price of cigarette and tobacco products to the extent that the tax increase is passed along to consumers. Based on historical data related to Proposition 10 and the tobacco settlement, and research of similar experiences in other states, along with research of other states' experiences, BOE staff believes the proposed cigarette tax increase and resulting increase in the tobacco products tax could result in both a decrease in actual consumption and an increase in tax evasion. The exact magnitude of these variables is uncertain since the proposed excise tax increase is significantly greater than prior tax increases.

6. **Increase in state and local sales and use tax revenues.** The total retail sales price of tangible personal property is subject to the sales or use tax, unless specifically exempted or excluded by law. Since the proposed cigarette tax increase and indirect tobacco products tax is not specifically exempted or excluded, it would be included in the total sales price and, therefore, subject to sales or use tax.

To be reimbursed for the proposed new taxes, a distributor, wholesaler, or retailer would likely incorporate the additional taxes into the sales price of the cigarettes and tobacco products sold to other licensees or consumers. The Revenue Estimate discusses the impact on state and local sales and use tax revenues.

7. **Distributor discount.** RTC Section 30166 requires stamps and meter impression settings to be sold to licensed distributors at their denominated values less 0.85%. The discount helps defray the distributor's cost (leasing of equipment/labor cost) for affixing the stamps to cigarette packages.

Currently, distributors receive a discount of \$221.85 [(30,000 stamps x \$0.87 tax per package of cigarettes) x 0.85% discount = \$221.85 discount] per roll of 30,000 cigarette tax stamps. A \$2.87 excise tax on a package of cigarettes increases the distributors' discount to \$731.85 [(30,000 stamps x \$2.87 tax per package of cigarettes) x 0.85% discount = \$731.85 discount] per roll of 30,000 stamps.

8. **Cost reimbursement cap is problematic.** This bill does not specifically authorize BOE reimbursement for costs to administer and collect the proposed tax. The bill does, however, limit funding for any department's administrative costs to 2% of the Tobacco Tax Fund revenues. The BOE staff recommends an amendment to specify on-going administrative cost reimbursement to the BOE. Although the 2% cap appears to provide adequate funding, the BOE suggests removing it.

30130.54. (a) The California Tobacco Tax Act of 2015 Fund is hereby established in the State Treasury for the purposes set forth in this article. All revenues, less refunds and reimbursement of the board for expenses incurred in the administration and collection of the taxes imposed under section 30130.51, derived from the taxes imposed by this article shall be deposited in the California Tobacco Tax Act of 2015 Fund.

30130.55. After transferring the moneys as required pursuant to subdivision (b) of Section 30130.53 and pursuant to subdivision (b) of Section 30130.54, the Controller shall allocate the moneys from the accounts in the California Tobacco Tax Act of 2015 Fund as follows:

~~(d) Not more than 2 percent of the funds received from the California Tobacco Tax Act of 2015 Fund shall be used by any department for administrative costs.~~

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

(ed) The Department of Justice, the State Department of Public Health, the State Department of Education, the State Department of Health Care Services, and the University of California shall, on an annual basis, publish on their respective Internet Web sites an accounting of moneys received from the California Tobacco Tax Act of 2015 Fund and how the moneys were spent.

Furthermore, it is unclear whether the 2% cost cap applies to the BOE's total costs to administer the additional tax and additional enforcement moneys allocated to the BOE from the Tobacco Law Enforcement Account, or only the costs to administer the additional tax.

9. **Proposition 99 backfill.** This measure requires the BOE to determine the effect of the additional cigarette tax and indirect tobacco products tax on cigarette and tobacco products consumption. To the extent that a consumption decrease directly results from the additional cigarette tax and indirect tobacco products tax increase, the bill requires the BOE to determine the fiscal effect of the consumption decrease on the existing cigarette tax funds: Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, the CCF Trust Fund, and General Fund. The bill directs an amount transferred from the Tobacco Tax Fund to each of the existing cigarette and tobacco products tax funds to offset the revenue decrease resulting from this measure's additional cigarette and indirect tobacco products tax increase.

In addition to the backfill, the bill indirectly increases the tobacco products tax. Existing law requires the BOE to deposit those new revenues into the Proposition 99-enacted Cigarette and Tobacco Products Surtax Fund. The BOE estimates a backfill to the Cigarette and Tobacco Products Surtax Fund in the amount of \$35.8 million in 2016-17. In addition, BOE staff estimates \$101.7 million in new revenues deposited into the Cigarette and Tobacco Products Surtax Fund.

10. **Enhanced enforcement funding.** The bill requires an unspecified percentage of Tobacco Tax Fund revenues to be appropriated, in part, to the Tobacco Law Enforcement Account. The Controller must appropriate moneys from this account to the BOE, DOJ, and CDPH for the purposes of:

Supplementing funding for the enforcement of laws that regulate the distribution and sale of cigarettes and other tobacco products, including, but not limited to, laws that prohibit cigarette smuggling, counterfeiting, selling untaxed tobacco, selling tobacco without a proper license and selling tobacco to minors, and enforcing tobacco-related laws, court judgments, and settlements.

The bill does not specify an allocation percentage to each of the agencies. To clarify the allocation process and prevent confusion regarding how to spread the administrative costs of the three agencies that together exceed the account balance, BOE suggests specifying an allocation percentage for each agency. A percentage-based allocation also improves each agency's ability to plan and anticipate staff and available resources.

11. **Licensing Act funding.** In 2003, Assembly Bill 71 (J. Horton, Ch. 890) enacted the Licensing Act, which established a statewide licensure program administered by the BOE to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products. Currently, the BOE licenses 35,000 retailers and 900 distributors and wholesalers to engage in the sale of cigarettes and tobacco products in California.

As Assembly Bill 71 made its way through the Legislature, revenue projections indicated that revenue beyond the licensure fees would be needed to sustain the Licensing Act program. Since the Licensing Act enforces the CTPTL and directly benefits the funds established pursuant to that program, the bill was amended to require that the cigarette and tobacco products tax funds<sup>7</sup> cover

---

<sup>7</sup> General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Prop. 99) and California Children and Families Trust Fund (Prop. 10).

the difference between the amount received in licensure fees and the funds needed for the program. Specifically, the uncodified language provides:

All revenues and expenses generated by this act with respect to the taxes imposed under the Cigarette and Tobacco Products Tax Law (Part 13 (commencing with Section 30001) of Division 2 of the Revenue and Taxation Code), shall be allocated in the same manner as those revenues and expenses are allocated under the Cigarette and Tobacco Products Tax Law **as that law read on the effective date of this act.**

It does not appear that the tax revenues generated by this bill could be used to reimburse the BOE's Licensing Act administrative costs because the tax proposed in this bill was not effective on the date of the Licensing Act.

**Administrative Costs:** BOE administrative costs related to this bill are substantial. These costs include: taxpayer notification, tax return design, computer programming, cigarette tax stamp design and denomination changes, compliance and audit efforts to ensure proper reporting, and floor stock tax administration.

Furthermore, the bill requires enhanced efforts to ensure proper floor stock tax reporting and collection, greater compliance efforts for additional billings and delinquencies, and an increase in BOE program and investigative staff presence due to increased tax evasion.

## Revenue Impact:

### Background, Methodology, and Assumptions

**Timing of Enactment.** Fiscal Year (FY) 2015-16 revenues depend on when this measure is enacted. The tax is triggered on the first day of the first calendar quarter more than 90 days after the bill is chaptered. October 11, 2015 is the last day the Governor has to sign or veto bills passed by the Legislature. While the Governor may sign the bill on or before September 30, (which would imply a January 1 implementation date) staff will assume an April 1, 2016 implementation date, which means that revenue impact in FY 2015-16 will be about a quarter of the revenue impact under a complete fiscal year.

**Cigarette Tax.** In FY 2013-14, 871 million tax-paid cigarette packs were distributed. Since 1980, tax-paid distributions have decreased about 3% per year. Staff believes that the 3% annual decline represents a reasonable estimate of the underlying trend for future years. This trend shows no clear signs of abating; thus, tax-paid cigarette distributions will likely decline by about 3% annually for FY 2014-15 and future years absent federal or state law changes.

Based on previous tax increases, academic studies, and research of experience in other states, staff believes a tax rate increase as sizeable as proposed by this bill likely would cause both a decrease in actual consumption and an increase in tax evasion. Although the exact magnitude of the split between evasion and consumption is uncertain, staff estimates tax-paid distributions to decrease by 18%. This estimate uses a price elasticity of demand of -0.70 calculated by the arc price elasticity formula, applied to an average estimated November 1, 2015 price of approximately \$5.78 per pack.<sup>8</sup>

**Enforcement Funding.** This measure provides funding to support additional law enforcement efforts to reduce cigarette smuggling. However, the bill does not specify the percentage of revenues that must move to the Tobacco Law Enforcement Account. Nor does the bill specify how much funding the BOE will receive for law enforcement. Regardless of the amounts allocated to additional law enforcement, with administrative and budgetary process timing lags, staff does not think this funding will affect law enforcement efforts for at least one year after enactment.

---

<sup>8</sup> The general price elasticity of demand formula is:  $e_p = (Q_1 - Q_2) / ((Q_1 + Q_2) / 2) / (P_1 - P_2) / ((P_1 + P_2) / 2)$ , where P = price and Q = sales.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

**Floor Stock Tax.** This bill includes a corresponding floor stock tax imposed on inventories on April 1, 2016, the projected implementation date. Staff assumes a three-week supply of cigarettes would be subject to the floor stock tax, based on a combination of expected sales rates before and after the tax takes effect. Since taxpayers have 180 days after April 1 to remit the tax, the assumption is that all revenue related to floor stock tax is received in FY 2016-17.

**Tobacco Products Tax.** Pursuant to Proposition 99, this measure would result in an additional tobacco products tax equivalent to the new \$2 per pack tax imposed on cigarettes. The BOE sets the tobacco tax rate prior to the start of each fiscal year using wholesale cost data available as of March 1. In recent years, the BOE has set the rate for the upcoming fiscal year in April or May. FY 2016-17 would be the first year the tobacco tax rate calculations would include the proposed tax rate increase.

The tobacco products tax is based on the wholesale cost of these products at a tax rate equivalent to the tax rate imposed on cigarettes. The rate is determined by dividing the tax rate per cigarette by the average wholesale cost per cigarette. In recent years, wholesale costs of cigarettes have risen, which results in rate declines since the total California excise tax on cigarettes has been constant since 1999. The BOE set the rate for FY 2014-15 at 28.95%. FY 2016-17 would be the first fiscal year affected by this measure. Staff estimates that, with the additional \$2 per pack tax, the tobacco products tax rate in FY 2016-17 would be 64.72%.

The wholesale cost (or wholesale sales) of tobacco products was about \$272 million in FY 2013-14. Tobacco product wholesale cost has increased an average of about 8.7% per year over the past three years; therefore, the assumption is that wholesale costs will grow 8.7% per year without the proposed tax increase.

Based on previous tax increases, tax rate increase as sizeable as proposed by this bill is likely to cause both a decrease in actual consumption and an increase in tax evasion of tobacco products; consequently, staff estimates sales of tobacco products will decline by a similar percentage as cigarette sales.

**Sales and Use Tax Impact.** Staff expects that all of the cigarette and tobacco products excise tax increases will be passed on to consumers. For both cigarettes and tobacco products, staff added sales tax to the excise tax increase and subtracted from the excise tax increase the sales tax that would decline due to a decline in projected sales to determine net sales tax gains.

### Revenue Summary

The revenue impact is shown in the table on the next page. Under the assumed enactment date, FY 2016-17 will be the first complete year of the measure's impact. For FY 2016-17 the Tobacco Tax Fund created by this bill would receive \$1,302.7 million from cigarette sales at the new tax rate. However, the other cigarette excise funds (including the existing General Fund) would lose a combined total of \$124.7 million because fewer packs would be sold. Nonetheless, the new tax revenues would backfill all of these funds. After backfilling, this bill would generate net revenues of \$1,178 million for the Tobacco Tax Fund. The tobacco products tax revenue and sales tax revenue impact are also shown in the bottom part of the table. Proposition 99 tobacco products revenues would increase by \$101.7 million, while Proposition 10 tobacco revenues would decrease by \$5.7 million due to reduced sales of tobacco products, resulting in a net increase of \$96 million for all tobacco products revenue. State and local sales and use tax revenue from both cigarettes and tobacco products combined would increase by \$38.7 million. In FY 2016-17, this measure would generate \$1,437.4 million (\$1,302.7 million + \$96.0 million + \$38.7 million) in total revenue.

Staff expects cigarette and related taxable sales revenues to decline in FY 2017-18 and future years for three reasons. First, the floor stock tax revenue (a one-time inventory tax) of \$86 million will be paid in FY 2016-17. Second, tax-paid cigarette distribution would continue to decrease by about 3% per year. Without any other factors affecting revenue, related revenue also would weaken by about 3% per year.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.



Finally, the 0.25 percent State Education Protection Fund (sales tax) rate ends December 31, 2016, further reducing revenue associated with the sales and use tax.

With the exception of forecasting greater declines in tax-paid cigarette and tobacco distributions, this revenue estimate does not account for any further changes in economic activity that may or may not result from enactment of the proposed law.

<b>Revenue Impacts Summary</b>	
	<b>Fiscal Year 2016-17 (Millions)</b>
Cigarette Excise Tax Revenue Impacts by Fund	
Impacts on Existing Funds:	-\$124.7
General Fund	-\$14.3
Breast Cancer	-\$2.9
Proposition 99	-\$35.8
Proposition 10	-\$71.7
<b>California Tobacco Tax Act of 2015 Fund (Before Backfilling)</b>	<b>\$1,302.7</b>
<b>Floor Stocks Tax (Included in the Total of Line Above)</b>	<b>\$86.0</b>
<b>California Tobacco Tax Act of 2015 Fund:</b>	
<b>Net Total Cigarette Excise Tax Revenues (After Funds are Backfilled)</b>	<b>\$1,178.0</b>
Net Tobacco Tax Revenue Increase (Propositions 99 and 10; see below)	\$96.0
<b>Total Net Increase (Cigarette Plus Tobacco Taxes)</b>	<b>\$1,274.0</b>
Sales and Use Tax: State General Fund	\$19.2
State Education Protection Fund	\$0.6
Local Sales and Use Tax	\$14.5
Special Districts Tax	\$4.4
<b>Total</b>	<b>\$1,437.4</b>
<b>Associated Revenue Impacts on Other Tobacco Tax Revenues</b>	
<b>(Change from revenues under current law, millions of dollars)</b>	
Proposition 99	\$101.7
Proposition 10	-\$5.7
<b>Total Impact</b>	<b>\$96.0</b>